(2)

No. 92-868

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

REPUBLIC INSURANCE GROUP, ET AL.,

Petitioners,

v.

CYNTHIA M. MALESKI, Acting Insurance Commissioner of the Commonwealth of Pennsylvania, as Rehabilitator of the Mutual Fire, Marine and Inland Insurance Company,

Respondent.

Petition For Writ Of Certiorari To The Supreme Court Of Pennsylvania

BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

(1) Where the sole issue presented is whether or not the Plan of Rehabilitation grants more restrictive rights of setoff than Petitioners would receive in a liquidation and where the Pennsylvania Supreme Court held, based upon its interpretation of the Pennsylvania Insurance Department Act, that, with respect to setoff, the rights of creditors set forth in the Plan of Rehabilitation are the same as they would be in liquidation, should the Petition for Writ of Certiorari be denied?

(2) Where the Pennsylvania Supreme Court, in interpreting the Pennsylvania Insurance Department Act, has held that the substantive law of the Commonwealth of Pennsylvania (in the context of insurance insolvency proceedings) grants creditors the same setoff rights in rehabilitation as it does in liquidation, and where the sole issue raised in the Petition is that Petitioners will not receive the same rights in rehabilitation as they would in liquidation, should this Court consider issues involving the state court's interpretation of substantive state law?

(3) Where Petitioners concede that the specific contract provisions relied upon for their Contract Clause claim, as well as the "representative" contract provisions appended to their Petition, were not entered into the record below, should this Court consider Petitioners' claim that the Plan impairs those contract provisions in violation of Article I, Section 10 of the United States Constitution?

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COUNTERSTATEMENT OF THE CASE

Respondent is Cynthia M. Maleski, the Acting Insurance Commissioner of the Commonwealth of Pennsylvania, as Statutory Rehabilitator ("Rehabilitator") of The Mutual Fire, Marine and Inland Insurance Company ("Mutual Fire"). On December 8, 1986, the Commonwealth Court of Pennsylvania entered an Order placing Mutual Fire into rehabilitation pursuant to the Pennsylvania Insurance Department Act (the "Act"), 40 P.S. § 221.15(a), and appointing the Insurance Commissioner of the Commonwealth of Pennsylvania as Rehabilitator pursuant to 40 P.S. § 221.15(c).[1]

Mutual Fire is a mutual insurance company which was incorporated in 1902 under the laws of the Commonwealth of Pennsylvania.[2] Before it ceased writing business in 1986, Mutual Fire's business included a broad range of property, casualty and special risks insurance, with substantial reliance upon reinsurance. Mutual Fire is licensed to do business in Pennsylvania, Delaware, New York and Puerto Rico, and operates on a surplus lines (non-admitted) basis in virtually every other state.

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[1] Under the Pennsylvania Insurance Department Act, the Commonwealth Court is assigned jurisdiction over, and supervisory responsibility for, insurance rehabilitations and liquidations. 40 P.S. § 221.4.

[2] Mutual Fire has no parent company. Mutual Fire's subsidiaries, as defined by Sup. Ct. R. 29.1, are: Endmark Data Processing Corporation; Ryansure Intermediaries, Inc.; Cable Life Insurance Co.; UMI Asset Management; and UMI Holdings.

Article V of the Act governs the rehabilitation and liquidation of insolvent insurance companies in Pennsylvania. Its stated purpose is "the protection of the interests of insureds, creditors, and the public generally" through, *inter alia*, "equitable apportionment of any unavoidable loss." 40 P.S. § 221.1(c). The Act affords the Insurance Commissioner, as statutory rehabilitator, broad discretion and authority to "take such action as [s]he deems necessary or expedient to correct the condition or conditions which constituted the grounds for the order of the court to rehabilitate the insurer." *Foster v. Mutual Fire, Marine & Inland Insurance Company*, 1992 W.L. 210948 (Pa. Aug. 21, 1992) (A-6 - A-7),[3] citing 40 P.S. § 221.16(b). This includes the discretion and authority to formulate a plan for rehabilitating an insolvent insurance company. 40 P.S. § 221.16(d).

On January 31, 1989, pursuant to 40 P.S. § 221.16(d), the Rehabilitator submitted to the Commonwealth Court a Plan of Rehabilitation for Mutual Fire (the "Plan"). Various creditors, including Petitioners, who are both cedents to and reinsurers of Mutual Fire,[4] filed objections to the Plan. On July 25, 26, 28, and August 1, 1989, hearings were held before the Honorable James Crumlish, Jr., then President Judge of the Commonwealth Court, to consider the proposed Plan.

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[3] References to the Appendix in the Petition are designated as "A- ___; B- ___."

[4] Cedents are companies whom Mutual Fire reinsures. Reinsurers are companies obligated to Mutual Fire under contracts of reinsurance, having assumed Mutual Fire business. Mutual Fire Plan, § I(4), (26).

The Plan establishes separate classes of creditors based upon the priority of distribution set forth in 40 P.S. § 221.44. Pertinent classes include:

Class 1 – Secured Cedents;

Class 2 – Administrative Claims;

Class 3 – Wage Claims;

Class 4 – Policyholder Claims (which excludes surety bond lenders, cedents and reinsurers);

Class 5 – Surety Bond lenders;

Class 6 – General Unsecured Creditor Claims (including those of cedents and reinsurers).

The Plan directs the Rehabilitator to marshal estate assets, in particular, reinsurance recoveries, which constitute the most significant and substantial asset of Mutual Fire. (Hearing Transcript, T. 40, 44.) Nevertheless, the Plan gives appropriate recognition to the traditional equitable remedy of setoff between cedents and reinsurers. Under Section III(D), mutual debts and credits, to the extent that such obligations were due and owing as of December 4, 1986 (the date on which the Insurance Commissioner filed her Petition for Rehabilitation) may be set off.[5] Thus, the Plan expressly permits creditors to exercise

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[5] The term "due and owing" refers to reinsurance amounts recoverable on paid Losses (*i.e.*, payments by cedents to policyholders and claimants), paid Loss Adjustment Expenses, Claim settlements and reimbursement agreements. Mutual Fire Plan, § I(11).

their right to set off matured, liquidated obligations as of the date of the filing of the Rehabilitation Petition. Case reserves as of December 4, 1986 (which are estimates of the amounts required to cover future payments on account of known claims) and IBNR as of that date (amounts predicted to be paid in the future on account of events that have occurred but have not been reported as claims) are not mutual debts under Pennsylvania law and thus, are not available for setoff.

While the Plan allows setoff of mutual debts and credits as stated above, Section III(B) precludes setoff of any premium obligations due to Mutual Fire. This provision is based upon 40 P.S. § 221.32(b)(4), which expressly prohibits setoff of premium obligations:

> (b) No setoff or counterclaim shall be allowed in favor of any person where:
>
> (4) The obligation of the person is to pay premiums, whether earned or unearned, to the insurer.

40 P.S. § 221.32(b)(4). This provision applies both to rehabilitations and liquidations. (A-15 - A-16.)

During the course of four days of hearings on the Plan, Petitioners, while contending, *inter alia*, that the foregoing Plan provisions impaired their rights under reinsurance contracts with Mutual Fire, failed to offer those reinsurance contracts with Mutual Fire into evidence. Petitioners now concede that the contract provisions which are the subject of their Petition "were not entered into the record below." (Petition, p. 2, n.2.)

In an Opinion and Order dated January 23, 1990, the Commonwealth Court (per then President Judge

Crumlish) approved, with certain modifications, the Plan submitted by the Rehabilitator and concluded as follows:

> Having considered all objections and found that the proposed Plan, with modifications, constitutes an equitable apportionment of unavoidable loss, is in the best interests of insureds and other creditors, and does not constitute an abuse of the Rehabilitator's discretion, we modify the Plan consistent with this Opinion and approve it in all other respects.

Grode v. Mutual Fire, Marine & Inland Insurance Company, 132 Pa. Commw. 196, 572 A.2d 798 (1990) (B-23). In particular, the Commonwealth Court modified Section III(D) and imposed the following additional requirements with respect to setoff:

> (i) the Rehabilitator is to notify creditors of her setoff calculations within 90 days of approval of the Plan;
>
> (ii) creditors have 30 days to object to the setoff calculation; and
>
> (iii) any dispute over the setoff calculation is to be resolved pursuant to the claim resolution procedures of Section VII of the Plan. (B-24.)

Petitioners appealed this Order to the Pennsylvania Supreme Court and argued, *inter alia*, that the Plan's setoff provisions restricted the setoff otherwise available to them in a liquidation proceeding, and that Section III of the Plan impermissibly impaired their contractual rights.

The Pennsylvania Supreme Court rejected both of these arguments. With respect to the question Petitioners

have presented for review by this Court, the Pennsylvania Supreme Court made the following specific findings:

> (1) Section III of the Plan "ensures that the creditors herein, at a minimum, will fare at least as well under the rehabilitation as they would in a liquidation proceeding," in accordance with *Neblett v. Carpenter*, 305 U.S. 297 (1938). (A-16.)
>
> (2) 40 P.S. § 221.32, which establishes what forms of setoff will be permitted, encompasses both liquidation and rehabilitation in Pennsylvania. (A-16.)
>
> (3) "Mutual debts and credits" under 40 P.S. § 221.32 are limited to debts which are due and owing (*i.e.*, liquidated, matured) as of December 4, 1986, the date upon which the petition for rehabilitation was filed. (A-19, citing *Commonwealth ex rel. Bell v. Tradesmen's Trust Company*, 250 Pa. 372, 95 A. 574 (1915).)
>
> (4) The "speculative and intangible nature" of case reserves and IBNR at the time of the filing of the petition for rehabilitation "does not warrant their being available for setoff." (A-19.)
>
> (5) Under Pennsylvania law, setoff is an equitable remedy and accordingly, "is permissive, not mandatory." (A-19.)
>
> (6) Allowing reinsurers/cedents to set off obligations that had not matured as of the filing of the rehabilitation petition would result in a windfall. (A-19.)
>
> (7) Section III of the Plan satisfied the three-part test set forth by this Court in *Energy Reserves Group, Inc. v. Kansas Power and Light*, 459 U.S. 400 (1983). (A-19.)

REASONS FOR REFUSAL OF THE WRIT

Petitioners' entire argument in support of review is premised upon a flawed assumption, *i.e.*, that they "would have been allowed to offset fully Case Reserves and IBNR" in a liquidation under 40 P.S. § 221.32, and thus, will not fare as well in rehabilitation. (Petition, p. 12.) To make this argument, however, Petitioners ignore completely the Pennsylvania Supreme Court's interpretation of that statute provision and settled Pennsylvania law.

The Pennsylvania Supreme Court specifically determined that the Mutual Fire Plan satisfied the requirements of *Neblett v. Carpenter*, 305 U.S. 297 (1938), *reh'g denied*, 305 U.S. 675 (1939). According to the Pennsylvania Supreme Court:

> Under *Neblett*, creditors must fare at least as well under a rehabilitation plan as they would under a liquidation, which [Petitioners] currently argue, would not be the case under this Plan. We disagree. . . . (A-12.)

The Court also found that Section III of the Plan complied with the Act's relevant provisions regarding setoff (40 P.S. § 221.32), which apply to rehabilitations, as well as to liquidations. (A-16.)[6] Thus, the Court held, under the Plan's setoff provisions, creditors (including Petitioners) "at a minimum, will fare at least as well under the rehabilitation as they would in a liquidation proceeding, as

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[6] In fact, the Plan, as modified by the Commonwealth Court, specifically incorporates 40 P.S. § 221.32, removing any doubt that setoff under the Plan is identical to setoff under the Act.

mandated by the holding of *Neblett, supra.*" (A-16.) Petitioners' assertions that the Pennsylvania Supreme Court "refused to apply" this Court's decision in *Neblett* (Petition, p. 10), simply make no sense.

Petitioners do not challenge the constitutionality of any Pennsylvania statute. Rather, they merely seek review of the Pennsylvania Supreme Court's decision approving the Mutual Fire Plan of Rehabilitation. In essence, their disagreement lies with that Court's findings and conclusions with respect to matters of substantive Pennsylvania law. Petitioners would have this Court substitute its judgment for that of the Pennsylvania Supreme Court in matters involving the interpretation of (1) the Pennsylvania Insurance Department Act and its provisions regulating insolvent insurance companies; and (2) Pennsylvania common law governing "mutual" debts and credits, and creditor setoff rights. This Court, which does not sit as an appellate arm of the state courts, has consistently refused to exercise its jurisdiction over such matters of substantive state law. *Hortonville Dist. v. Hortonville Ed. Assoc.*, 426 U.S. 482, 488 (1976); *Ridgway v. Ridgway*, 454 U.S. 46, 54 (1981).

With respect to their claim under Article I, Section 10 of the United States Constitution (the "Contract Clause"), Petitioners are asking this Court to assess the Plan's impact upon "explicit contractual rights," the provisions regarding which were never made part of the record in the state court proceedings. (Petition, p. 2.) In any event, the Pennsylvania Supreme Court specifically found that (i) the Plan did not constitute a substantial impairment of Petitioners' contractual setoff rights; and (ii) the Plan's

setoff provisions served a legitimate and significant public purpose. (A-12, A-13.)

A. THE PENNSYLVANIA SUPREME COURT'S DECISION APPROVING THE PLAN DEALS EXCLUSIVELY WITH MATTERS OF SUBSTANTIVE PENNSYLVANIA LAW

Behind the constitutional "labels" that Petitioners attach to their arguments, there is only one issue raised in the instant Petition: what constitutes a "mutual" debt, under Pennsylvania law, for purposes of the setoff provisions of 40 P.S. § 221.32. The Supreme Court specifically found that case reserves and IBNR, which are unliquidated and contingent as of the date of the filing of a petition for rehabilitation, are not "mutual" under Pennsylvania law (whether in rehabilitation or liquidation) and hence, not subject to setoff. (A-19.) Petitioners contend that the Pennsylvania Supreme Court should have ignored fundamental principles of Pennsylvania law (A-19), and adopted the definition of "mutual" obligations set forth in *In re Midland Insurance Company*, 590 N.E.2d 1186 (N.Y. 1992) (applying New York law), and *Stamp v. Insurance Company of North America*, 908 F.2d 1375 (7th Cir. 1990) (construing Illinois law).

This Court considers itself "bound to accept the interpretation of [state] law given by the highest court of the state," *Hortonville Dist.*, 426 U.S. at 488, and has emphasized that decisions of state courts will be subject to disturbance only to the extent that "they incorrectly adjudge *federal* rights." *Ridgway*, 454 U.S. at 54 (emphasis

added). Petitioners here are simply challenging the Pennsylvania Supreme Court's interpretation of Pennsylvania law; this is not, and never has been, a basis for seeking review by this Court.

Petitioners attempt to avoid the prohibition against reviewing questions of state law by arguing that this case involves issues of "national importance." (Petition, pp. 8-10.) However, Petitioners' sudden concern with the national and international impact of the Pennsylvania Supreme Court's decision approving the Mutual Fire Plan is not only suspect, but late in arriving. While Petitioners insist that their contractual setoff provisions are "at the heart of most reinsurance contracts" and "of critical importance" to the reinsurance industry (Petition, p. 9), they failed to make these "critical" contracts part of the record in the state court proceedings. (Petition, p. 2, n.2.)[7]

Moreover, Petitioners' current claims that reinsurers may be "far less likely" to assume reinsurance from smaller companies in Pennsylvania and that the Pennsylvania Supreme Court's decision "could result" in a further contraction of reinsurance capacity (Petition, p. 10), are clearly speculative, and were not borne out by evidence or testimony at the hearings on the Plan. In fact, a reinsurance expert who appeared on behalf of various cedents (Petitioners at Case No. 92-937), testified that his chief concern with the Plan's setoff provisions was that his companies would be forced to monitor transactions

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[7] Petitioners' belated attempt to modify the record by appending to their Petition in this Court "standard" clauses, which they claim are found in most reinsurance contracts, is no substitute for a proper record.

more closely and devote more time and effort to keeping their accounting up to date:

> THE WITNESS: But more particularly, since we are talking about offset, it's a tool that, first of all, saves me money.
>
> If we would have to go ahead and carefully monitor it, any insurance or reinsurance company in the State of Pennsylvania, I as an underwriter would insist that my accounting department settle immediately. If I owed them money, pay them the money; but if they owe me money, I would almost insist upon a simultaneous transfer of checks. . . .
>
> * * *
>
> THE COURT: . . . Is this the [gravamen] of the problem; namely, that it's going to require the industry and particularly Mr. FitzPatrick's clients to do a lot more than they're customarily doing in order to protect their interests? Is that right?
>
> THE WITNESS: Yes, sir.

(T. 492-493, 495.)

Mere inconvenience, the Rehabilitator respectfully submits, does not translate into an issue of "national importance."

B. THE PENNSYLVANIA SUPREME COURT EXPRESSLY FOUND THAT THE PLAN SATISFIES THE REQUIREMENTS OF *NEBLETT*

As stated, in considering *Neblett*, the Pennsylvania Supreme Court removed any need to compare setoff

rights under liquidation and rehabilitation when it ruled that Section 221.32 of the Act applies to rehabilitations as well as to liquidations. (A-16.)[8] Thus, regardless of whether Mutual Fire is in rehabilitation or liquidation, Petitioners would only be permitted to set off "mutual" debts and credits as provided under Section 221.32.[9]

The Court then held that "mutual" debts and credits, *under Pennsylvania law*, must be present, mature obligations as of the date of the filing of the petition for rehabilitation. According to the Court:

> [N]o right of setoff can be available against a note or other obligation that does not mature until after a receiver for the insolvent debtor is appointed. *Commonwealth ex rel. Bell v. Tradesmen's Trust Company*, 250 Pa. 372, 95 A. 574 (1915). *Accord, Appeal of Commonwealth Trust Co. of Pittsburgh*, 324 Pa. 161, 188 A. 200 (1936).

(A-19.)

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[8] The Pennsylvania Supreme Court stressed that § 221.32 begins by stating that its provisions apply to any action or proceeding "under this article." (A-16.) The term "article" refers to Article V of the Act, which encompasses both rehabilitations and liquidations. *Id.*

[9] 40 P.S. § 221.32 provides, in pertinent part, that "mutual debts or mutual credits . . . shall be set off and the balance only shall be allowed or paid, except as provided in subsection (b)." Subsection (b) expressly prohibits setoff where, *inter alia*, (1) the obligation of the insurer to the person seeking setoff would not, at the date of the filing of a petition for liquidation, entitle that party to share as a claimant in the insurer's assets and (4) the obligation is to pay premiums, whether earned or unearned, to the insurer.

For more than a century, Pennsylvania courts had relied upon this basic principle:

> Whatever may be the rights of a party whose debt is due and payable to compel an insolvent debtor to set off a claim against him not due, a party whose debt is not due has no equitable claim to have it set off against a debt of his own already due in the hands of a party who is insolvent.

Dougherty Bros. & Co. v. Central National Bank, 93 Pa. 227 (1880) (citations omitted). This view is still widely accepted. *See, e.g., Liberty Sav. Ass'n v. Sun Bank of Jacksonville*, 572 F.2d 591, 595 (7th Cir. 1978) (" . . . a debt is not subject to setoff unless it has matured. . . . "); *In Re Cabrillo*, 101 Bankr. 443 (E.D. Pa. 1989) (setoff was denied in a bankruptcy proceeding with respect to an installment loan agreement, as opposed to a demand note); *see also FDIC v. Liberty Nat'l Bank & Trust Co.*, 806 F.2d 961, 969 (10th Cir. 1986), and *Henz v. Superior Trucking Co.*, 96 F.R.D. 219 (M.D. Pa. 1982).

In conformity with this precedent, the Court simply restated the obvious, that case reserves and IBNR[10] "are not present obligations of the reinsurer" and that:

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[10] The category of claims allowed to be set off under the Plan (the "due and owing" amounts) were matured, liquidated obligations of Mutual Fire on the date the Commissioner petitioned for rehabilitation. In the context of a reinsurance agreement, the due and owing amount represents the funds already paid by the primary insurance company, which amounts are fixed, readily ascertainable, and currently payable to the primary insurer by the reinsurance company. On the other hand, case reserves are merely the primary insurance company's estimates of the amounts which it may expend in the future in

> [c]ase reserves and IBNR are at most calculations or estimates of future, potential liabilities, which often times are contingent upon a later development or growth of the claim or some intervening procedure such as litigation.

(A-19.) It then reached the inevitable conclusion that the unliquidated nature of case reserves and IBNR at the time of the filing of the petition for rehabilitation "does not warrant their being available for setoff. . . . " *Id.* The Pennsylvania Supreme Court's interpretation of Pennsylvania law with regard to "mutuality" is not an adjudication of "federal rights" and thus, is not a subject for review by this Court. *Ridgway*, 454 U.S. at 54.

The record in this case amply supports the decision to limit setoff to liquidated due and owing amounts, as of December 4, 1986. At the hearings on the Plan, the cedents' expert testified that, even in non-insolvency situations, the industry-wide practice was to use net balance accounting (*i.e.*, setoff) and that it applied only to due and owing balances, not case reserves or IBNR. (T. 489, 537-538.) If setoff as practiced within the insurance industry only applies to due and owing amounts, Petitioners can hardly complain that the same principle in the Plan somehow violates their contract rights.

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defending, settling or otherwise disposing of claims which have been reported to it. Only future events (*e.g.*, a jury verdict) will determine whether additional funds will be expended on any particular claim and, if so, in what amounts. Likewise, IBNR amounts represent an estimate of expenses that *may* be incurred on account of events that have occurred but have not yet ripened into claims or been reported to the primary insurance company.

Not only are the Plan's setoff provisions, as approved by the Pennsylvania Supreme Court, consistent with well-established Pennsylvania legal principles and the factual record, but they also implement the important public policy behind the Act of maximizing the protection to policyholders. (40 P.S. § 221.1(c).) Thus, the Pennsylvania Supreme Court correctly concluded that allowing Petitioners to set off obligations against Mutual Fire that had not matured as of the time of filing the petition for rehabilitation (case reserves and IBNR) would result in a "windfall" to Petitioners not available to policyholders. (A-19 - A-20.)

In addition, the setoff demanded by Petitioners would wreak havoc with the Act's equitable distribution scheme under which innocent third parties (policyholders), who are dependent upon the financial obligations of these reinsurers to Mutual Fire, have been assigned a priority above that of cedents and reinsurers. As the Pennsylvania Supreme Court observed:

> . . . [T]he exigencies attendant to a major commercial insolvency and the goals of rehabilitation necessitate the reality that "individual interests may need to be compromised in order to avoid greater harm to a broader spectrum of policyholders and the public."

(A-13), citing *Vickodil v. Commonwealth Insurance Dept.*, 126 Pa. Commw. 390, 559 A.2d 1010, 1013 (1989).

C. THE SPECIFIC CONTRACT PROVISIONS RELIED UPON BY PETITIONERS WERE NOT ENTERED INTO THE RECORD BELOW; IN ANY EVENT, THE PLAN DOES NOT VIOLATE THE CONTRACT CLAUSE

Petitioners have not met their threshold burden of demonstrating that they in fact possess contractual rights

altered by the law. *National Railroad Passenger Corp. v. Atchison, Topeka & Santa Fe Railway Co.*, 470 U.S. 451, 472 (1985). While Petitioners argue that the Plan impairs their "explicit contractual rights" (Petition, p. 2) and "largely overrides" the setoff provisions of their reinsurance contracts (Petition, p. 14), they concede that these very reinsurance contracts, which allegedly have been rendered "null and void," were never made part of the record in the state court proceedings. (Petition, pp. 2, 4.) Petitioners certainly should not be permitted to ask this Court to pass upon "standard" clauses, which they claim are found "in most reinsurance contracts." (Petition, p. 2.)

Even more egregious, however, is Petitioners' selected editing of the "standard" clause from which they quote at p. 2 of their Petition. Petitioners fail to include the following provision, which modifies setoff in the event of insolvency of either party:

> . . . provided, however, that in the event of the insolvency of a party hereto, offsets shall only be allowed in accordance with the provisions of Section 538 of the Insurance Law of the State of New York.

(G-4 - G-5.)[11] If this "standard" contract is truly representative of Petitioners' reinsurance contracts with Mutual Fire, Petitioners should not be heard to argue, 15 pages later in their Petition, that the setoff provisions in Mutual Fire's Plan were "sudden" or "totally unanticipated." (Petition, p. 17.) Nor is it conceivable that Petitioners had

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[11] Section 538 of the Insurance Law of the State of New York (NY Law § 7427) is similar to 40 P.S. § 221.32, with the exception of the prohibition against premium setoff.

no reason to expect that a rehabilitator in Pennsylvania could regulate setoff when one of the parties to a reinsurance contract becomes insolvent. The Pennsylvania Supreme Court, in fact, specifically found that Petitioners "are members of a highly regulated industry and as such were well aware of the powers of a rehabilitator." (A-14, n.4.)

In any event, the Pennsylvania Supreme Court addressed the Contract Clause challenge raised by Petitioners (A-14, n.4) and properly found that the Plan's setoff provisions satisfied the three-part test set forth by this Court in *Energy Reserves Group, Inc. v. Kansas Power and Light*, 459 U.S. 400 (1983). Additionally, it is well settled that the prohibition in Article I, Section 10 of the United States Constitution against impairing the obligations of contracts "is not to be read literally," *Keystone Coal Assoc. v. DeBenedictis*, 480 U.S. 470, 502, (1987), but must be accommodated to the inherent power of the state "to safeguard the vital interests of its people." *Energy Reserves*, 459 U.S. at 410. The Pennsylvania Supreme Court's decision approving the Plan leaves absolutely no doubt that the Plan, including its setoff provisions, is necessary for the public good as it legitimately and reasonably fosters the goals of rehabilitation *announced by the Legislature, i.e.*, "equitable apportionment of any unavoidable loss." (A-14 - A-17.)

Moreover, the Plan's setoff provisions hardly constitute "special interest" regulation favoring policyholders, as Petitioners suggest. After all, the Pennsylvania Legislature has established the priority of distribution for creditors of an insolvent insurance company, and has elevated policyholder claims above those of reinsurers/cedents. Allowing the unlimited setoff which Petitioners seek

would make a mockery of that priority scheme by raising Petitioners to the level of secured creditors. If Petitioners had wanted security for Mutual Fire's reinsurance obligations, they certainly could have demanded it, as other secured creditors had done. Instead, Petitioners chose to rely upon their alleged setoff clauses. Having done so, their vague and nebulous Constitutional assertions should not be considered by this Court.

CONCLUSION

For the foregoing reasons, it is submitted that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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